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Subject: **Report by President's Economic Recovery Advisory Board Addresses Options for Simplifying the Tax Code and Encouraging Retirement Saving**

Major References: [*Report of the President's Economic Recovery Advisory Board on Tax Reform Options: Simplification, Compliance and Corporate Taxation*](#)

Prior AALU Washington Reports: 10-86; 10-84

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As called to your attention in our Bulletin No. 10-86, the President's Economic Recovery Advisory Board ("PERAB" or the "Board") has issued its report (the "Report") on the advantages and disadvantages of tax reform options relating to tax simplification, enforcement of existing tax laws and reforming the corporate tax system. A section of the Report addresses eight options for simplifying savings and retirement incentives. Additionally, the Report, in another portion -- a portion addressing options for broadening the corporate tax base, suggests eliminating tax expenditures resulting from special rules that apply to employee stock ownership plans ("ESOPs").

PERAB was established by Executive Order on February 6, 2009. Its functions, which are advisory only, include researching and reporting directly to the President on the design, implementation and evaluation of policies to promote the growth of the U.S. economy, establishing a stable and sound financial and banking system, and creating jobs. The Report was prepared, in response to a request by President Obama, by a subcommittee of Board members, which included a number of economists of contrasting political views, such as conservative Martin Feldstein and liberal Laura Tyson. The Report was adopted by

the full Board at the end of August. It does not contain specific recommendations; rather it proposes a number of options for satisfying the goals set by the President.

Options relating to retirement savings are:

(1) Consolidating the Different Types of Retirement Plans. This proposal suggests consolidating sections 401(k), 403(b) and 457 plans into one type of plan, since many of their features are similar. A natural consequence would be a uniform set of eligibility and contribution rules for employer-sponsored plans.

(2) Removing Income Limitations on IRA Contributions. Under this proposal, any worker could contribute to an IRA regardless of whether he or she participates in an employer-sponsored plan. Although the current limits would continue to apply to IRAs and 401(k) plans, the combined employee pre-tax contributions to the IRA and an employer-sponsored plan could not exceed the 401(k) limitation. Contributions to nondeductible IRAs would no longer be permitted.

(3) Consolidating and Segregating Non-Retirement Savings. This option would consolidate into one vehicle Section 529 plans, Coverdell IRAs, health savings accounts ("HSAs"), Archer medical savings accounts ("MSAs") and flexible spending accounts ("FSAs"). The contributions to this consolidated account would be tax-deductible up to a specified limit. An alternative option would permit after-tax contributions to such accounts, under which earnings would accumulate tax-free and qualified distributions would be excluded from income. A second alternative would consolidate all education savings in one type of account and all health savings in another type.

(4) Improving Savings Incentives. This proposal replaces the Savers credit with a matching contribution made to an IRA. Additionally, the ability to receive a matching contribution would be subject to an income phase-out system rather than ending abruptly at certain income levels, as occurs under the current system. Another option addressed in the Report for improving savings is the automatic payroll reduction IRA. There has been legislation introduced in both the House and the Senate to establish such a program. (See our Bulletin No. 10-84 addressing this proposed legislation.)

(5) Reducing Retirement Account Leakage. In response to concerns that amounts set aside for retirement are distributed to employees for non-retirement reasons and are then unavailable at retirement, the Report proposes to increase the restrictions on distributions by requiring a terminating employee either to keep his or her account in the employer's retirement plan or to roll it over into an IRA. Distributions would not be permitted at termination of employment prior to age 59-1/2 except in the case of death or disability. Hardship distributions would be permitted, but the standard for such distributions would be more stringent and would be uniform regardless of the type of account (IRA, 401(k), 403(b), etc.) in which the moneys are held.

(6) Simplifying Rules for Employer Sponsors. Under this option, an employer could choose to forgo nondiscrimination testing in favor of a standard safe harbor. That safe harbor would require all medium and large employers to make contributions to their plans at least equal to a specified minimum amount; the current SIMPLE 401(k) safe harbor would apply to small employers. An alternative to this proposal would repeal current nondiscrimination testing requirements and impose the safe harbor on all employers.

(7) Creating a Threshold for Required Minimum Distributions. This proposal removes the age 70½ minimum distribution requirements for accounts with balances of less than \$50,000.

(8) Simplifying the Taxation of Social Security Benefits. Under this option, the portion of social security benefits required to be included in income would be equal to a specified percentage of such

benefits that exceed a certain threshold. The Report provides an example of where social security retirees would be required to include in income 40% of social security benefits that exceed \$12,000.

(9) Removing Special Advantages to ESOPs. Although the Report did not offer specific proposals, it noted that eliminating special tax provisions applicable to ESOPs would raise revenues and harmonize tax incentives with other retirement plans. The Report appears to be focusing on the rules that allow employers to deduct dividends paid on stock held by ESOPs and on those that permit an individual selling stock to an ESOP to make a section 1042 election to defer the tax on the sales proceeds.

The discussion in the Report of its above proposals includes attention to the advantages and disadvantages associated with each. It is not entirely clear how some of these proposals will impact plan sponsors. Although the purpose of certain of them is to reduce the administrative burdens associated with employer-sponsored retirement plans, not all of them necessarily lead to such reductions. For example, the payroll reduction IRA would require increased administration for employers. Additionally, the current retirement system with its multiple types of plans allows an employer to tailor its retirement benefits to the needs and capabilities of the business along with the needs of the employees. Reducing choice could cause some employers to eliminate their retirement plans. Furthermore, the safe harbor option offered in place of the current nondiscrimination testing requirements, if too stringent, could further erode employer plan sponsorship.

Any AALU member who wishes to obtain a copy of the *PERAB Report on Tax Reform Options: Simplification, Compliance and Corporate Taxation* may do so through the following means: (1) use hyperlink above next to “Major References,” (2) log onto the AALU website at www.aalu.org and enter the *Member Portal* with your last name and birth date and select *Current Washington Report* for linkage to source material or (3) email Anthony Raglani at raglani@aalu.org and include a reference to this *Washington Report*.

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